

Income from the publication and sale of a book by an exempt organization is unrelated business income; however, if it transfers its publication rights to a commercial publisher, royalty income received is not unrelated business income.

Advice has been requested whether, in the situation described below, income derived by an organization subject to the provisions of section 511 of the Internal Revenue Code of 1954 constitutes unrelated business taxable income within the meaning of section 512 of the Code.

The organization, which is exempt from Federal income tax under section 501(a) of the Code, engages primarily in activities in furtherance of its exempt purposes. It also owns the publication rights to a book. The publication and distribution of the book will not contribute in any manner to the accomplishment of the exempt purposes of the organization except for the organization's need for the income to be derived therefrom.

The organization has undertaken to exploit the book in a commercial manner. It has arranged for the printing, distribution, and retail sale of the book. The organization has also arranged for appropriate publicity and advertising in connection with the distribution and sale of the book.

The specific question presented is whether the organization's activities relating to the book constitute the conduct of a trade or business regularly carried on within the meaning of section 512 of the Code.

Section 512 of the Code provides that unrelated business taxable income is the income derived by an organization from any unrelated trade or business regularly carried on by it. Section 512(b)(2) provides that income derived from royalties is to be excluded in computing unrelated business taxable income.

Section 513 of the Code defines the term 'unrelated trade or business' as any trade or business the conduct of which is not substantially related (aside from the need of such organization for the income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purposes.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is 'substantially related' to exempt purposes when the business activity has a substantial causal relationship to the achievement of the exempt purposes. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from

which the gross income is derived must contribute importantly to the accomplishment of those purposes.

It is held that the organization's activities in connection with the publication, distribution, and sale of the book in the manner described constitute the conduct of a trade or business regularly carried on and that the income derived is unrelated business taxable income under section 512 of the Code.

However, had the organization transferred the publication rights to a commercial publisher in return for royalties, the royalty income derived would have been excluded from the computation of unrelated business taxable income under section 512(b)(2) of the Code.